Lanka Rating Agency

Rating Report

People's Bank

Report Contents

Rating History

Dissemination Date	Long Term Rating	Outlook	Action	Rating Watch
06-Sep-2024	AA	Stable	Initial	-

Rating Rationale and Key Rating Drivers

People's Bank's ("PB" or "the Bank") rating reflects its sovereign ownership (majority owned by the Government of Sri Lanka (GoSL)), established position as a retail bank, and its significance as a designated Domestic Systemically Important Bank (DSIB) in Sri Lanka. The Bank holds the second largest market share in the Licensed Commercial Banks (LCBs) industry in terms of its total assets, deposit base and loan portfolio standing at LKR 3.1tn, LKR 2.7tn and LKR 1.9tn, respectively, as of Mar'24. The rating also takes into account the Bank's strong capitalization, diverse deposit base, and improved liquidity profile. The rating also factors in the impact of sustained improvements in the key macroeconomic variables, such as reduced inflation, declining interest rates, and a relatively stable exchange rate. Moreover, conclusion of domestic debt optimization (DDO) and recent developments on dollar denominated sovereign bonds provide more clarity, although PB had limited exposure to sovereign bonds that is well provided. During CY23, the Bank's liquidity profile demonstrated a notable improvement with liquidity coverage ratio (LCR) at ~257% at End-Mar'24 (Dec'22: ~213%, Dec'21: ~155%). Being one of the two state-owned Banks in Sri Lanka, PB's loans & advances are reflective of exposure to the state-owned enterprises (SOEs) with its top 20 advances majorly comprising SOEs and constituting a sizable portion of its total loans & advances (Dec'23). Propensity for GoSL support remains very high, if needed. Moreover, PB's standalone financial profile has the ability to withstand the eventual impact of SOEs' debt restructuring (if any) to an extent. The Bank's gross stage 3 loans to total loans clocked in at ~14.7% as at End-Mar'24, slightly higher than its comparable peers, while growth in its loans & advances remained muted at ~1% (End-Mar'24) in tandem with the LCBs Industry. Going forward, an uptick in the economic activity is likely to catalyze the growth in the Industry's loans and advances. PB's exposure to exchange risk remains in check, with ~17% of its loans & advances and ~11% of its deposit base pertaining to foreign currency. The Bank holds a modest share in GoSL International Bonds, while it maintains a significant portfolio in the domestic Government Securities. (G-Sec). The Bank's Net Interest Income (NII) reduced to LKR 54bn in CY23 (CY22: LKR 76bn) and stood at LKR 12bn in 3MCY24 (LKR 12bn in 3MCY23) attributable to lower spreads. Resultantly, PB's Profit-After-Tax (PAT) declined to LKR 10bn in CY23 (LKR 17bn in CY22) and LKR 516mn in 3MCY24 (LKR 3.4bn in 3MCY23). The Bank's Capital Adequacy Ratio (CAR) of ~16.1% (regulatory requirement for DSIB is 13.5%) in 3MCY24 is slightly lower than industry average.

The rating is dependent on the Bank's ability to sustain its asset quality and improve its capitalization indicators. Improvement in spreads and profitability amidst changing economic conditions is important. Any material impact on the financial position and/or liquidity position of the Bank, due to its exposure to GoSL (investment in sovereign debt and lending to SOEs) or otherwise, will have negative impact on the rating.

Disclosure

Name of Rated Entity	People's Bank
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Financial Institution Rating(Jun-22)
Related Research	Sector Study | Commercial Bank (Sep-23)
Rating Analysts	Gayani Randima Ariyawansa | gayani@lra.com.lk | +94 114 500099

Profile

Structure People's Bank ("PB" or "the Bank") is a state-owned bank established under the People's Bank Act No. 29 of 1961. It is also registered under the Banking Act No. 30 of 1988.

Background PB was incorporated in 1961 with nine branches opening in its first year. The Bank's asset base surpassed LKR 1.0tn in CY14, while the deposits and advances base surpassed LKR 1.0tn in CY16 and CY17 respectively.

Operations The Bank's principal operations consist of accepting deposits, granting credit facilities, dealing in government securities, investment banking, and an offshore banking unit for foreign currency banking.

Ownership

Ownership Structure The majority shares of the Bank are owned by the Treasury on behalf of the Government of Sri Lanka ("GoSL"), with a ~92.3% stake in the Bank. As a state-owned bank, it directly comes under the purview of the Ministry of Finance ("MoF").

Stability PB is a Domestic Systemically Important Bank ("DSIB") in Sri Lanka and therefore brings strategic importance to the GoSL. The MoF and the DSIB status of the Bank brings stability to the ownership of the Bank.

Business Acumen Since the Bank comes directly under the purview of the MoF, PB stands to gain industry-specific knowledge from the Government.

Financial Strength As per the People's Bank Act No. 29 of 1961, The MoF provides a guarantee to loans and advances granted with the approval of the relevant Minister, in consultation with the Minister of Finance. The MoF has infused capital on several occasions to the Bank and would make further infusions, if the need arises.

Governance

Board Structure The People's Bank Act No. 29 of 1961 has laid out the manner in which the Board is to be structured. The Bank has a board of eight Non-Executive directors, out of which three members are Independent directors.

Members' Profile The Chairman of the Bank, Mr. Rajapakse has nearly four decades of experience in accounting, auditing, and human resource management. Other members of the Board hold decades of experience in fields such as banking, law, digital forensics, IT, and project management.

Board Effectiveness The board has formed nine board sub-committees to run its operations smoothly. Mr. Thotawatte heads the BAC with over 38 years of experience in finance. These committees facilitate the Board of Directors for effective governance and management.

Financial Transparency The External Auditors of the Bank, The National Audit Office, issued an unqualified audit opinion pertaining to the Annual Financial Statements for CY23.

Management

Organizational Structure The management of the Bank is overseen by the CEO. All departments of the Bank report to the Chief Executive Officer ("CEO")/ General Manager ("GM"), through their respective Deputy General Managers ("DGM").

Management Team The management team is headed by the CEO/GM, Mr. Fonseka. He was appointed to the role in August'23 and has over 28 years of experience in treasury management. He is supported by an able and experienced team of professionals.

Effectiveness The Bank has formed six management committees, namely, i) Assets and Liabilities Committee, ii) Credit Risk Management Committee, iii) Operational Risk Management Committee, iv) Information Security Steering Committee, v) Executive Operations Committee, vi) Executive Credit Committee.

MIS The Bank uses Silver Lake Integrated Banking System as the core operating system. It also has separate systems for treasury, pawning, and other services.

Risk Management Framework The Bank has a risk management framework based on the three lines of defense model. The BIRMC advises the Board of Directors on risk-related matters.

Business Risk

Industry Dynamics The Banking Industry comprises 30 Banks, out of which, 24 are Licensed Commercial Banks (LCBs) and 6 are Licensed Specialized Banks (LSBs). Out of the 24 LCBs, there are eleven (11) Foreign Banks, eleven (11) Private Banks and two (2) Public Banks including the PB. As at End-Dec'23, the sector recorded an asset base of LKR 20.4tn, reflecting a growth of ~5%, compared to End-Dec'22. Similarly, the Investments and Deposit base of the sector also increased by ~23.1% and ~7.4% YoY respectively during CY23. However, the sector's net advances reduced slightly by ~3.3% compared to CY22. The sector's Net Interest Income (NII) was recorded at LKR 714.6bn during CY23, a decline of ~4.9% YoY basis. This came on the backdrop of combined effect of rising interest rates during 1HCY23 and the lagged repricing adjustments on the sector's Advances portfolio. Despite the decline, the sector's Profit-After-Tax (PAT) increased by ~25.2% during CY23 to LKR 192.6bn, compared to LKR 153.8bn in CY22.

Relative Position PB continues to maintain its position as the second largest LCB in Sri Lanka with an asset base of LKR 3.1tn, representing ~14.9% of the sector's total assets as at End-Dec'23. In addition, the Bank holds sector's Advances and Deposit base accounting for ~17.5% of the sector's total Advances and ~16.1% of the sector's total Deposit base. On the other hand, the Bank contributed ~7.6% to the sector's Net Interest Income (NII) and ~5.2% to the Sector's Profit-After-Tax (PAT) for the same period.

Revenues Gross income of the Bank stood at LKR 422.2bn in CY23 which is a 18.2% increase compared to CY22. The Bank earned a Net Interest Income ("NII") of LKR 54.3bn during CY23, which is a ~28.3% drop since the previous year. However, the Bank's interest income reduced by 19.8%, while the interest expense dropped by 22.5% in 3MCY24 compared to 3MCY23.

Performance During 3MCY24, the Bank's profitability declined by ~84.9% to LKR 516.5mn compared to the same period last year. During CY23, the profitability dropped by ~41.4% to LKR 10.1bn from LKR 17.2bn in CY22. It was a result of the high-interest expenses, increase in operating cost and impairment due to the high-interest rate environment. PB's cost of funds increased significantly in CY23 to ~12.3% (CY22: ~9.5%), as a result of the interest expense increasing rapidly compared to CY22. In CY23, even though there was a significant increase in other operating income and decline in impairment cost by approximately ~125.3% and ~-77.7%, the Bank's profitability reduced by ~28.1%. This is primarily due to high interest expenses during the period outpacing the growth in operating income and decline in impairment charge.

Sustainability The Bank plans to focus more on upholding stringent lending practices by increasing both rupee and foreign currency lending with emphasis on financial exporters. Since it has a sufficient branch network, PB expects to focus on increasing its digital footprint.

Financial Risk

Credit Risk The gross Stage 3 loans to total advances were recorded at ~15.4% (CY22: ~17.4%) while the net Stage 3 loans to total advances recorded at ~8.8% (CY22: ~12.8%) in CY23. The top 20 advances represented sizable amount of gross advances with the majority being State-Owned Enterprises (SOEs). The provision coverage has been maintained above 40% during CY23.

Market Risk The Bank increased its investment in Government Securities (G-Sec) during CY23 and 3MCY24. Recently the bank has also increased its investments in G-Sec to LKR 1.0tn (CY22: 926.1bn) with the majority being held for the short-term duration. The G-Sec have remained over ~96% of its investments since CY19. PB's investments in International Sovereign Bonds remain low and well provided for.

Liquidity And Funding The Bank is reliant on deposits as it constituted ~93.7% (CY23: ~93.4%) of the funding as of 3MCY24. The Bank holds a positive net open position in its foreign currency exposure as of Dec'23. Time deposits take a larger portion of the deposits at ~68.0%, closely followed by savings deposits, which take up ~28.0% as of CY23. The top 20 deposits concentration is minimum at ~15.3% (CY23: ~14.4%) as of 3MCY24.

Capitalization The Bank's Capital Adequacy Ratio (CAR) is recorded at ~16.1% as of 3MCY24, while the required rate of the Central Bank of Sri Lanka is 13.5%. The Tier I capital is LKR 126.0bn, while the total capital is LKR 178.0bn. The bank has also issued a perpetual Tier I bond of LKR 5.0bn to support its CAR.

LRA

Financials (Summary) in LKR mln

Lanka Rating Agency

	Mar-24	Dec-23	Dec-22	Dec-21
Peoples Bank	LKR mln			
Licensed Commercial Bank	3M	12M	12M	12M
A BALANCE SHEET				
1 Stage I | Advances - net	1,363,772	1,238,832	1,299,876	1,567,767
2 Stage II | Advances - net	209,496	305,044	257,670	197,809
3 Stage III | Advances (NPLs)	275,002	283,762	332,794	153,350
4 Stage III | Impairment Provision	(118,925)	(118,180)	(107,234)	(83,229)
5 Investments	1,050,595	1,047,375	947,149	604,618
6 Debt Instruments	8,091	8,300	10,400	9,428
7 Other Earning Assets	85,575	74,776	11,552	3,191
8 Non-Earning Assets	218,793	198,286	219,820	194,706
Total Assets	3,092,399	3,038,195	2,972,028	2,647,641
6 Deposits	2,714,912	2,653,106	2,371,519	2,071,533
7 Borrowings	182,774	188,500	339,584	398,027
8 Other Liabilities (Non-Interest Bearing)	34,147	36,531	115,632	42,004
Total Liabilities	2,931,834	2,878,136	2,826,734	2,511,563
Equity	160,565	160,059	145,294	136,077
B INCOME STATEMENT				
1 Mark Up Earned	80,318	394,795	321,936	197,330
2 Mark Up Expensed	(68,304)	(340,473)	(246,178)	(114,869)
3 Non Mark Up Income	3,586	27,447	35,293	9,920
Total Income	15,601	81,769	111,051	92,381
4 Non-Mark Up Expenses	(15,028)	(51,668)	(48,170)	(40,659)
5 Provisions/Write offs/Reversals	1,397	(7,438)	(33,346)	(14,473)
Pre-Tax Profit	1,970	22,664	29,534	37,249
6 Taxes	(1,454)	(12,581)	(12,342)	(13,528)
Profit After Tax	516	10,083	17,192	23,720
C RATIO ANALYSIS				
1 Revenues				
Advances' Yield	13.5%	16.1%	12.9%	9.0%
Spread | Asset Yield - Cost of Funds	2.4%	2.9%	3.6%	3.9%
2 Performance				
Cost of Funds [Mark Up Expensed / Average (Deposits + Borrowings)]	9.5%	12.3%	9.5%	5.1%
ROE	1.3%	6.6%	12.2%	19.9%
3 Capital Adequacy				
Capital Adequacy Ratio	16.1%	17.4%	16.3%	17.8%
Net Stable Funding Ratio [Available Stable Funding / Required Stable Funding]	170.0%	164.3%	117.1%	115.4%
4 Funding & Liquidity				
Liquid Assets / (Deposits + Borrowings Net of Repo)	38.4%	38.3%	34.7%	21.5%
Demand & Saving Deposit Coverage Ratio	1.3	1.3	1.2	0.6
Top 20 Deposits / Deposits	15.3%	14.4%	13.7%	13.7%
5 Credit Risk				
Impaired Loan Ratio | [Stage III | Advances (NPLs) / Gross Advances]	14.7%	15.4%	17.4%	7.9%
Provision Coverage Ratio | [Impairment Provision / Stage III | Advances (NPLs)]	43.2%	41.6%	32.2%	54.3%

Credit Rating

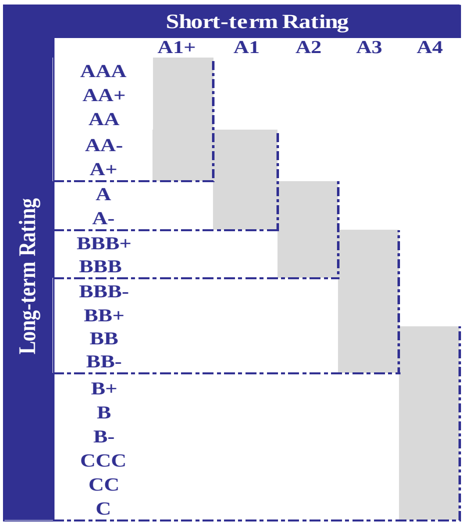
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long-term Rating

Scale	Definition
AAA	**Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
AA+ AA AA-	**Very high credit quality.** Very low expectation of credit risk. Indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.
A+ A A-	**High credit quality.** Low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be vulnerable to changes in circumstances or in economic conditions.
BBB+ BBB BBB-	**Good credit quality.** Currently a low expectation of credit risk. The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances and in economic conditions are more likely to impair this capacity.
BB+ BB BB-	**Moderate risk.** Possibility of credit risk developing. There is a possibility of credit risk developing, particularly as a result of adverse economic or business changes over time; however, business or financial alternatives may be available to allow financial commitments to be met.
B+ B B-	**High credit risk.** A limited margin of safety remains against credit risk. Financial commitments are currently being met; however, capacity for continued payment is contingent upon a sustained, favorable business and economic environment.
CCC CC C	**Very high credit risk.** Substantial credit risk "CCC" Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon sustained, favorable business or economic developments. "CC" Rating indicates that default of some kind appears probable. "C" Ratings signal imminent default.
D	Obligations are currently in default.

Short-term Rating

Scale	Definition
A1+	The highest capacity for timely repayment.
A1	A strong capacity for timely repayment.
A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
A4	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions. Liquidity may not be sufficient.



**The correlation shown is indicative and, in certain cases, may not hold.*

Outlook (Stable, Positive, Negative, Developing) Indicates the potential and direction of a rating over the intermediate term in response to trends in economic and/or fundamental business/financial conditions. It is not necessarily a precursor to a rating change. 'Stable' outlook means a rating is not likely to change. 'Positive' means it may be raised. 'Negative' means it may be lowered. Where the trends have conflicting elements, the outlook may be described as 'Developing'.

Rating Watch Alerts to the possibility of a rating change subsequent to, or, in anticipation of some material identifiable event with indeterminable rating implications. But it does not mean that a rating change is inevitable. A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled. Rating watch may accompany rating outlook of the respective opinion.

Suspension It is not possible to update an opinion due to lack of requisite information. Opinion should be resumed in foreseeable future. However, if this does not happen within six (6) months, the rating should be considered withdrawn.

Withdrawn A rating is withdrawn on a) termination of rating mandate, b) the debt instrument is redeemed, c) the rating remains suspended for six months, d) the entity/issuer defaults., or/and e) PACRA finds it impractical to surveill the opinion due to lack of requisite information.

Harmonization A change in rating due to revision in applicable methodology or underlying scale.

Surveillance. Surveillance on a publicly disseminated rating opinion is carried out on an ongoing basis till it is formally suspended or withdrawn. A comprehensive surveillance of rating opinion is carried out at least once every six months. However, a rating opinion may be reviewed in the intervening period if it is necessitated by any material happening.

Note. This scale is applicable to the following methodology(s):

a) Broker Entity Rating
b) Corporate Rating
c) Debt Instrument Rating
d) Financial Institution Rating
e) Holding Company Rating
f) Independent Power Producer Rating
g) Microfinance Institution Rating
h) Non-Banking Finance Companies Rating

Regulatory and Supplementary Disclosure

(Rules applicable to Credit Rating Agencies, No. 19 of 2021 - issued on 15th March 2022)

Rating Team Statements
(1) Credit Rating Agency means a body corporate engaged in the business of assessing and evaluating the credit- worthiness of any issuer or a specific issue of securities. https://www.sec.gov.lk/credit-rating-agency/

Conflict of Interest
(2) i. LRA will disclose to the Commission all other business activities it is engaged in at the time of applying for its licence and inform the Commission in writing prior to engaging in any other business activity after obtaining a licence from the Commission. (Section 34 – Rules applicable to Credit Rating Agencies)
(2) ii.LRA will not engage in any other business which in the view of the Commission creates a conflict of interest unless prior written approval of the Commission is obtained. (Section 35 – Rules applicable to Credit Rating Agencies)
(2) iii.In the conduct of any such other business activity, the LRA will ensure that proper processes are in place to have a clear demarcation of the different functions pertaining to such businesses. (Section 36 – Rules applicable to Credit Rating Agencies)

Restrictions
(3) (i) LRA will not be outsource any part of its work, which has a direct bearing on the function of rating. (Section 24 – Rules applicable to Credit Rating Agencies)
(3) (ii) LRA will enter into a written agreement with the party to whom any work is outsourced. Such agreement contains an undertaking from the party to whom any work is outsourced that they shall comply with the laws, rules, and directives that the LRA is bound to follow. (Section 25 – Rules applicable to Credit Rating Agencies)

(4) The LRA will not appoint any individual as a member of the rating committee who:
(a) has a business development function of the Credit Rating Agency; or
(b) who initiates or participates in discussions regarding fees or payments with any Client of the LRA. (Section 28 – Rules applicable to Credit Rating Agencies)

Conduct of Business
(5) Prior to the commencement of a rating or during such process the LRA will not promise, assure or guarantee to a Client that a particular rating will be assigned. (Section 39 – Rules applicable to Credit Rating Agencies)

(6) LRA performs a rigorous and formal periodic review of all its methodologies. Such methodologies will be made available to the Commission for perusal, upon request. (Section 41 – Rules applicable to Credit Rating Agencies)

Independence & Conflict of interest
(7) LRA receives compensation from the entity being rated or any third party for the rating services it offers. The receipt of this compensation has no influence on LRA´s opinions or other analytical processes. In all instances, LRA is committed to preserving the objectivity, integrity, and independence of its ratings.

(8) LRA will not engage in any other business which in the view of the Commission creates a conflict of interest unless prior written approval of the Commission is obtained. (Section 35 – Rules applicable to Credit Rating Agencies)

(9) LRA will structure its rating teams and processes to promote continuity, consistency and avoid bias in the rating process. (Section 47 – Rules applicable to Credit Rating Agencies)

Monitoring and review
(10) For purposes of transparency the LRA will publish sufficient information about an entity/security rated, frequency of default and whether a rating grade assigned has changed over time. The definitions and computation methods for the default rates stated in the default studies shall also be disclosed. (Section 44 – Rules applicable to Credit Rating Agencies)

LRA maintain the following records pertaining to Clients:
(a) all internal records to support its credit rating opinions;
(b) all particulars relating to Clients at its office which shall include the name and registered address and contact numbers of such Client, names and addresses of their directors as at the date of rating, its issued share capital and the nature of business; and
(c) a written record of all complaints received from Clients and action taken thereon by the LRA. (Section 48 – Rules applicable to Credit Rating Agencies)

(11) LRA maintains confidentiality of all non-public information entrusted to it by Clients at all times including such Client's identity and transactions carried out for such Client unless and to the extent such disclosure is required by law, or unless authorised by the Client to disclose such information. (Section 50 – Rules applicable to Credit Rating Agencies)

(12) LRA does not destroy, conceal or alter any records, property or books relating to the business of the Credit Rating Agency which are in its possession or under its control with the intention of defeating, preventing, delaying or obstructing the carrying out of any examination (Section 53 – Rules applicable to Credit Rating Agencies)

Probability of Default
(13) LRA's Rating Scale reflects the expectation of credit risk. The highest rating has the lowest relative likelihood of default (i.e., probability).

Proprietary Information